

## Federal Acquisition Regulation

## 16.402-2

(v) Prohibit earning any award fee when a contractor's overall cost, schedule, and technical performance is below satisfactory;

(vi) Provide for evaluation period(s) to be conducted at stated intervals during the contract period of performance so that the contractor will periodically be informed of the quality of its performance and the areas in which improvement is expected (*e.g.* six months, nine months, twelve months, or at specific milestones); and

(vii) Define the total award-fee pool amount and how this amount is allocated across each evaluation period.

(4) *Rollover of unearned award fee.* The use of rollover of unearned award fee is prohibited.

(5) *Limitations.* No award-fee contract shall be awarded unless—

(i) All of the limitations in 16.301-3, that are applicable to cost-reimbursement contracts only, are complied with;

(ii) An award-fee plan is completed in accordance with the requirements in 16.401(e)(3); and

(iii) A determination and finding is completed in accordance with 16.401(d) addressing all of the suitability items in 16.401(e)(1).

(f) *Incentive- and Award-Fee Data Collection and Analysis.* Each agency shall collect relevant data on award fee and incentive fees paid to contractors and include performance measures to evaluate such data on a regular basis to determine effectiveness of award and incentive fees as a tool for improving contractor performance and achieving desired program outcomes. This information should be considered as part of the acquisition planning process (see 7.105) in determining the appropriate type of contract to be utilized for future acquisitions.

(g) *Incentive- and Award-Fee Best Practices.* Each agency head shall provide mechanisms for sharing proven incentive strategies for the acquisition of different types of products and services among contracting and program management officials.

[48 FR 42219, Sept. 19, 1983, as amended at 62 FR 12695, Mar. 17, 1997; 74 FR 52858, Oct. 14, 2009]

EFFECTIVE DATE NOTE: At 75 FR 60263, Sept. 29, 2010, § 16.401 was amended by remov-

ing from paragraph (e)(2) the words “performance is” and adding “performance in the aggregate is” in its place each time it appears (twice).

Removing from Table 16-1 that follows paragraph (e)(3)(iv) the words “contract as” and adding “contract in the aggregate as” in its place each time it appears (five times); and

Removing from paragraph (e)(3)(v) the words “performance is” and adding “performance in the aggregate is” in its place.

### 16.402 Application of predetermined, formula-type incentives.

#### 16.402-1 Cost incentives.

(a) Most incentive contracts include only cost incentives, which take the form of a profit or fee adjustment formula and are intended to motivate the contractor to effectively manage costs. No incentive contract may provide for other incentives without also providing a cost incentive (or constraint).

(b) Except for award-fee contracts (see 16.404 and 16.401 (e)), incentive contracts include a target cost, a target profit or fee, and a profit or fee adjustment formula that (within the constraints of a price ceiling or minimum and maximum fee) provides that—

(1) Actual cost that meets the target will result in the target profit or fee;

(2) Actual cost that exceeds the target will result in downward adjustment of target profit or fee; and

(3) Actual cost that is below the target will result in upward adjustment of target profit or fee.

[48 FR 42219, Sept. 19, 1983, as amended at 62 FR 12696, Mar. 17, 1997; 62 FR 51379, Oct. 1, 1997; 74 FR 52859, Oct. 14, 2009]

#### 16.402-2 Performance incentives.

(a) Performance incentives may be considered in connection with specific product characteristics (*e.g.*, a missile range, an aircraft speed, an engine thrust, or a vehicle maneuverability) or other specific elements of the contractor's performance. These incentives should be designed to relate profit or fee to results achieved by the contractor, compared with specified targets.

(b) To the maximum extent practicable, positive and negative performance incentives shall be considered in connection with service contracts for performance of objectively measurable

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tasks when quality of performance is critical and incentives are likely to motivate the contractor.

(c) Technical performance incentives may be particularly appropriate in major systems contracts, both in development (when performance objectives are known and the fabrication of prototypes for test and evaluation is required) and in production (if improved performance is attainable and highly desirable to the Government).

(d) Technical performance incentives may involve a variety of specific characteristics that contribute to the overall performance of the end item. Accordingly, the incentives on individual technical characteristics must be balanced so that no one of them is exaggerated to the detriment of the overall performance of the end item.

(e) Performance tests and/or assessments of work performance are generally essential in order to determine the degree of attainment of performance targets. Therefore, the contract must be as specific as possible in establishing test criteria (such as testing conditions, instrumentation precision, and data interpretation) and performance standards (such as the quality levels of services to be provided).

(f) Because performance incentives present complex problems in contract administration, the contracting officer should negotiate them in full coordination with Government engineering and pricing specialists.

(g) It is essential that the Government and contractor agree explicitly on the effect that contract changes (e.g., pursuant to the Changes clause) will have on performance incentives.

(h) The contracting officer must exercise care, in establishing performance criteria, to recognize that the contractor should not be rewarded or penalized for attainments of Government-furnished components.

[48 FR 42219, Sept. 19, 1983, as amended at 62 FR 44815, Aug. 22, 1997]

### 16.402-3 Delivery incentives.

(a) Delivery incentives should be considered when improvement from a required delivery schedule is a significant Government objective. It is important to determine the Government's primary objectives in a given contract

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(e.g., earliest possible delivery or earliest quantity production).

(b) Incentive arrangements on delivery should specify the application of the reward-penalty structure in the event of Government-caused delays or other delays beyond the control, and without the fault or negligence, of the contractor or subcontractor.

### 16.402-4 Structuring multiple-incentive contracts.

A properly structured multiple-incentive arrangement should—

(a) Motivate the contractor to strive for outstanding results in all incentive areas; and

(b) Compel trade-off decisions among the incentive areas, consistent with the Government's overall objectives for the acquisition. Because of the interdependency of the Government's cost, the technical performance, and the delivery goals, a contract that emphasizes only one of the goals may jeopardize control over the others. Because outstanding results may not be attainable for each of the incentive areas, all multiple-incentive contracts must include a cost incentive (or constraint) that operates to preclude rewarding a contractor for superior technical performance or delivery results when the cost of those results outweighs their value to the Government.

### 16.403 Fixed-price incentive contracts.

(a) *Description.* A fixed-price incentive contract is a fixed-price contract that provides for adjusting profit and establishing the final contract price by application of a formula based on the relationship of total final negotiated cost to total target cost. The final price is subject to a price ceiling, negotiated at the outset. The two forms of fixed-price incentive contracts, firm target and successive targets, are further described in 16.403-1 and 16.403-2 below.

(b) *Application.* A fixed-price incentive contract is appropriate when—

(1) A firm-fixed-price contract is not suitable;

(2) The nature of the supplies or services being acquired and other circumstances of the acquisition are such that the contractor's assumption of a